

**Letter of Findings: 01-20190946  
Individual Income Tax  
For the Tax Years 2011 - 2017**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

### HOLDING

Married couple's protest for tax years 2011, 2012, 2015, and 2017 was late. Further, married couple failed to provide documentation supporting their position that the Department's proposed assessment of additional Indiana individual income tax for tax years 2013, 2014, and 2016 was incorrect. However, the imposition of a fraud penalty was not warranted in this situation because the Department did not provide clear and convincing evidence that Taxpayers' actions were fraudulent.

### ISSUE

#### I. Income Tax-Imposition.

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-10-4; *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012).

Taxpayers protest the imposition of additional Indiana individual income tax for tax years 2011 - 2017.

#### II. Tax Administration-Fraud Penalty.

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-10-4; *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); [45 IAC 15-5-7](#); [45 IAC 15-11-4](#).

Taxpayers challenge the imposition of a 100 percent fraud penalty.

### STATEMENT OF FACTS

Taxpayers, a married couple, live in Indiana and run a business in this state. Taxpayers were selected for an Indiana Department of Revenue ("Department") individual income tax audit for tax years 2011 - 2017 ("years at issue"). During the audit, the Department determined that Taxpayers did not keep adequate records to support their returns. Thus, the Department issued "best information available" tax assessments for the years at issue. Taxpayers filed a protest and an administrative hearing was held. This Letter of Findings results. Additional information will be provided as necessary.

#### I. Income Tax-Imposition.

### DISCUSSION

Taxpayers were subject to an individual income tax audit for the tax years at issue. During the audit, it was determined that Taxpayers did not have adequate records to support their returns as filed. Taxpayers protested stating that Taxpayers were "unschooled as to the operations of a business, . . . along with bookkeeping and record keeping requirements" and that they were working on providing additional documentation. Taxpayers were given over one hundred days to provide additional documentation. As of the date of this Letter of Findings, that additional documentation has not been provided.

As a threshold issue, all tax assessments are *prima facie* evidence that the Department's claim for unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Indiana Dept. of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2011); *Lafayette Square Amoco, Inc. v. Indiana Dept. of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2011).

As a result of the audit, Taxpayers were issued proposed assessments for tax years 2011 - 2017. The assessments for tax years 2011, 2012, 2015, and 2017 were issued on February 14, 2019. According to IC § 6-8.1-5-1(d), the proposed assessment "shall state that the [Taxpayer] has forty-five (45) days from the date the notice is mailed, if the notice was mailed before January 1, 2011, and sixty (60) days from the date the notice is mailed, if the notice was mailed after December 31, 2010, to pay the assessment or to file a written protest." Therefore, Taxpayers had sixty days from February 14, 2019 to file a written protest regarding tax years 2011, 2012, 2015, and 2017. Sixty days from February 14, 2019 was April 15, 2019. Taxpayers' written protest was not received until April 16, 2019, therefore, as it pertains to 2011, 2012, 2015, and 2017, Taxpayers' untimely protest is denied.

Taxpayers' proposed assessments for tax years 2013, 2014, and 2016 were dated February 15, 2019. Sixty days from that date was April 16, 2019; therefore, the protest, as it relates to 2013, 2014, and 2016 was timely. The audit found that Taxpayers' records did not adequately support Taxpayers' returns. Specifically, the audit found thirty bank accounts belonging to Taxpayers, only sixteen of which had bank statements. Therefore, the Department assessed tax using the best information available to it under IC § 6-8.1-5-1(b), which states:

If the [D]epartment reasonably believes that a person has not reported the proper amount of tax due, the [D]epartment shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the [D]epartment. The amount of the assessment is considered a tax payment not made by the due date and is subject to . . . penalties and interest."

It is the Taxpayers' burden to prove that the Department's assessments were incorrect. In doing so, the Taxpayers are required to provide documentation to support their position. Until and unless Taxpayers provide evidence that their 2013, 2014, and 2016 Indiana returns were correct, the Department cannot remove Taxpayers' assessments. Because Taxpayers have not met their burden under IC § 6-8.1-5-1(c), Taxpayers' protest is denied.

## FINDING

Taxpayers' protest for tax years 2011, 2012, 2015, and 2017 is denied as the protest was not timely filed. Taxpayers' protest for tax years 2013, 2014, and 2016 is denied as Taxpayers have not met their burden under IC § 6-8.1-5-1(c).

## II. Tax Administration-Fraud Penalty.

### DISCUSSION

The Department's audit determined that Taxpayers' returns were fraudulent and thus no time limit should be imposed in regards to issuing proposed assessments and Taxpayers were assessed with a 100 percent fraud penalty for each year at issue.

Again, all tax assessments are *prima facie* evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012). Thus, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

The fraud penalty is found at IC § 6-8.1-10-4, which states:

- (a) If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, the person is subject to a penalty.
- (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100[percent]) multiplied by:
  - (1) the full amount of the tax, if the person failed to file a return; or
  - (2) the amount of the tax that is not paid, if the person failed to pay the full amount of the tax.
- (c) In addition to the civil penalty imposed under this section, a person who knowingly fails to file a return with the department or fails to pay the tax due under [IC 6-6-5](#), [IC 6-6-5.1](#), or [IC 6-6-5.5](#) commits a Class A misdemeanor.
- (d) The penalty imposed under this section is imposed in place of and not in addition to the penalty imposed under section 2.1 of this chapter.

[45 IAC 15-11-4](#) further illustrates:

The penalty for failure to file a return or to make full payment with that return with the fraudulent intent of evading the tax is one hundred percent (100[percent]) of the tax owing. Fraudulent intent encompasses the making of a misrepresentation of a material fact (See [45 IAC 15-5-7\(f\)\(3\)](#)) which is known (See [45 IAC 15-5-7\(f\)\(3\)\(B\)](#)) to be false, or believed not to be true, in order to evade taxes. Negligence, whether slight or great, is not equivalent to the intent required. An act is fraudulent if it is an actual, intentional wrongdoing, and the intent required is the specific purpose of evading tax believed to be owing.

[45 IAC 15-5-7\(f\)\(3\)](#) describes the five elements of fraud:

A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements to fraud.

- (A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.
- (B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.
- (C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.
- (D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.
- (E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the department is required to prove all of the above elements are present. This must be shown by clear and convincing evidence.

The first element of fraud is misrepresentation of material fact; did Taxpayer fail to correctly report all the information required by the Indiana Code and Regulations? The Department notes that Taxpayers' income was "grossly under reported" and that, if not knowingly, Taxpayers at least recklessly made statements on their returns without regard for fact. As evidence of this, the Department points to Taxpayers' failure to reveal all of their bank accounts and, once identified, failure to provide bank statements for nearly half of their accounts. Taxpayers also failed to provide "1099k's, expense invoices, all 1099's received, and bookkeeping records." The Department noted that Taxpayers had opened several businesses, purportedly for other people. Finally, the audit found that Taxpayers had erroneously claimed an unrelated individual as a dependent on some of their returns. It certainly appears that Taxpayers, intentionally or not, made misrepresentations of material fact.

The second element of fraud is "scienter," which means that a taxpayer must have actual knowledge that they are making misrepresentations of material fact. The reckless making of statements without regard to their truth can impute scienter. Taxpayers explain that of the thirty bank accounts identified by the audit, a portion belong to family members; Taxpayers merely served as cosigners on the accounts. Regarding the lack of documentation in

relation to their business, Taxpayers state that they are working on providing documentation and claim that they were "unschooled" in the ways of running a business and record keeping requirements, but that they believe they "exhibited a reasonable and good faith effort in reporting their income." Though Taxpayers may have opened several businesses in the past, the only one reporting income is the one at issue in this decision. Further, while it was clear that Taxpayers wrongfully claimed an unqualified individual as a dependent, there is not enough information in the audit file to determine whether or not this was done with scienter. From the information provided in the file and in the audit report, it appears that Taxpayers may have been guilty of messy bookkeeping, lack of bookkeeping and a lack of knowledge on how to properly run a business; it is not clear that Taxpayers acted intentionally or with "scienter."

The third element of fraud is deception; did Taxpayers' actions, or lack thereof, cause the Department to believe a set of facts that were untrue? Without the Department's audit, it is probable that the Department would not have found out about Taxpayers' potential additional sources of taxable income. Thus, barring the Department's audit, the returns, as filed deceived the Department.

The fourth element of fraud is reliance. Considered along with deception, the question is whether a taxpayer's actions, or lack thereof, caused the Department to rely on a set of facts to its detriment. Again, had the Department not selected Taxpayers for audit, it is probable that the Department would have relied on the information as provided by Taxpayers' returns. The Department has determined that it is likely that this information under stated taxable income. Thus, the Department's reliance on those facts would have been to the Department's detriment.

The final element of fraud is injury. The "fraud" must have actually caused an injury. The mere fact that Taxpayers' misrepresentations caused the Department not to collect all of the money which properly belongs to the state of Indiana is enough to show injury. Without the Department's audit and resulting assessments, the Department would have, in fact, been injured.

As stated in [45 IAC 15-5-7\(f\)\(3\)](#), "[i]n order to demonstrate fraud, the [D]epartment is required to prove all of the [fraud] elements are present." While Taxpayers may be guilty of poor or uninformed financial and business management, this doesn't rise to the level of fraud. The audit pointed to some indirect evidence to serve as the justification for the audit's imposition of the fraud penalty, however there is not enough evidence to prove that Taxpayers acted with scienter. The fraud penalty is a serious and costly penalty and should only be levied when evidence of fraud is present and apparent.

### **FINDING**

Taxpayers' protest of the fraud penalty is granted.

### **SUMMARY**

Taxpayers' protest of the imposition of additional sales tax is respectfully denied. Taxpayers' protest of the imposition of the fraud penalty is granted.

December 5, 2019

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An [html](#) version of this document.